Report of Examination

of

Farmers Mutual Fire Insurance Company of Jefferson County, Tennessee, Inc.

Everett L. Gantte, Secretary
1205 Gay Street, P.O. Box 398
Dandridge, TN 37725

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AUG 1 3 2004
Dept. Of Commerce & Insurance
Company Examinations

Examination made as of: December 31, 2002

Examiner: James T. Pearce and Robert S. Creel

Examination commenced: January 12, 2004

Examination completed: August 13, 2004

Date of Report: August 13, 2004

Examined as of: December 31, 2002

Last Examination as of: December 31, 2001

Commissioner Paula A. Flowers
Department of Commerce and Insurance
State of Tennessee
Nashville, Tennessee 37243

Commissioner:

Pursuant to your instructions, I have made an examination and submit the following report of the conditions and affairs of the

Farmers Mutual Fire Insurance Company of Jefferson County, Tennessee, Inc.

Dandridge, Tennessee

Officers

Title	Name	Address	Term Expires
President	L.C. Batson	Dandridge, TN	July 2003
Vice President	Danny Layman	Dandridge, TN	July 2003
Secretary & Treasurer	Everette L. Gantte	Dandridge, TN	July 2003

Directors:

Name	Address	Term Expires
Everette L. Gantte	Dandridge, TN	July 2006
Danny Layman	Dandridge, TN	July 2004
L. C. Batson	Dandridge, TN	July 2004

Compensation of officers, directors, appraisers, adjusters, et al:

President	$500 per year
Secretary/Treasury	$3,000 per year
Bookkeeper	$605 per week
Asst. Bookkeeper/Clerk	$495 per week
Directors	$25.00 per meeting
Agents	$30.00 per meeting
Agent / Adjuster *	$15.00 per loss inspected (one payment per loss only)
Agent / Adjuster *	$15.00 per policy rewritten
Agent / Adjuster **	$30.00 per day or partial day
Agent / Adjuster **	$0.35 cents per mile
Re-appraisals (E. L. Gantte only)	$15.00 each

* Received by all Agents, except E. L. Gantte.

** Received by E. L. Gantte regularly and L. C. Batson on occasion

Report of changes in the Constitution or By-Laws, policy forms, or other agreements during the period covered by this examination.

2001 and 2002 - The Company began the process of moving from a post-assessment to pre-assessment premium billing system. In January 2001 the Company billed its policyholders $9.75 per thousand (for all lines except mobile homes) and $20.00 per thousand for mobile homes (mobile homes were defined as those that did not have a porch or were not underpinned) on a post-assessment basis (billed in January 2001 for 2000 coverage). The Company in July 2001 made another premium assessment for $6.00 per thousand (for all lines except mobile homes) and $12.00 per thousand for mobile homes. The Company's July 2001 premium assessment was for 2001 insurance coverage. In January 2002 the Company billed its policyholders $10.00 per thousand (for all lines except mobile homes) and $20.00 per thousand for mobile homes (mobile homes were defined as those that did not have a porch or were not underpinned) on a pre-assessment basis (billed in January 2002 for 2002 coverage).

The Company did not bill or collect the full amount of premium revenue for 2001 during the transition from a post-assessment premium collection basis to a pre-assessment collection basis. This was done by the Company to ease the transition for the insured. The Company collected $707,129 or approximately $145,000 less premiums than it should have in 2001 based upon the standard assessment made in January 2002 and premium income received in the 2002 calendar year ($426,234). Because the Company under assessed and did not collect the full amount of premium revenue for 2001 the Company had a negative net worth of $85,697.49 on a cash basis. Also, the 2001 under assessment caused the Company to end 2001 with a $104,468.08 outstanding principal loan balance payable to First Tennessee Bank which was carried over from the 2000 business year. This $104,468.08 outstanding principal loan balance plus $2,382.88 interest as of December 2001 was paid in full on January 31, 2002.

Subsequent Events :

Policy Coverage

In 2002 all policy forms issued noted coverage was extended for five (5) years from the policy issuance date. However, in 1983 by action of the Board of Directors all policies were continuous beyond the five (5) year date of issuance. Starting in April 2003 all policy forms issued noted coverage was continuous.

The Company can cancel any policy with five (5) days notice given to the policyholder and ten (10) days notice given to a policyholder that has a mortgage on the insured property.

If copies have not been filed with the Department of Commerce and Insurance, are they filed with the work papers of this report?

Yes. Changes to the Company's By-Laws and policy forms are included with the work papers of this report.

Report on reinsurance assumed and / or ceded.

Type:	Property First Surplus
Reinsurer:	Farmers Mutual of Tennessee
Term:	Continuous contract, effective August 1, 1993.
Coverage:	Covers four (4) times the net retention to $100,000 maximum per risk.

Type:	First Aggregate Excess of Loss
Reinsurer:	Farmers Mutual of Tennessee
Term:	Continuous contract, effective January 1, 1993.
Coverage:	Covers 95% of $263,158 excess 70% of net written premium income.

Type:	Second Aggregate Excess of Loss
Reinsurer:	Farmers Mutual of Tennessee
Term:	Continuous contract, effective January 1, 1993.
Coverage:	Covers 95% of $263,158 excess of 70% of net written premium income plus $263,158.

Appraisal and classification of risks taken.

The Company may insure dwellings, barns, farming equipment and other implements usually kept in barns and outbuildings, church buildings and contents, school buildings and contents, household goods and electrical appliances. Livestock may be insured individually, as a group, or by classes of animal.

Annual rate of assessment per $1,000.00 for period covered:

	1998	1999	2000	2001	2002
Mobile Homes	$20.00	$20.00	$20.00	$20.00	$20.00
Other Lines	$9.00	$9.00	$9.75	$9.75	$10.00

The Company did not charge a deductible for claim payments.

Rate of membership, policy and initial fees charged.

Entrance Fee (Sept. 1 – Dec. 31, 2002):	$5.00 per $1,000.00 (all lines except mobile homes)
Entrance Fee (Sept. 1 – Dec. 31, 2002):	$10.00 per $1,000.00 (for mobile homes)
Transfer fee:	$1.00 or membership fee

Effective April 15 2003 the Company stopped charging Entrance Fees to new policyholders and stopped remitting the full amount of Entrance Fees to their agents.

Date of last assessment.

January 2, 2002 was the date of the last assessment covering January 1 through December 31, 2002. This premium assessment was due March 1, 2002.

Amount delinquent.

The Company had arranged payment schedules for twelve (12) policyholders that were on fixed incomes or were otherwise financially challenged. As of year-end 2002 the Company had past due accounts from these policyholders totaling $6,448.75.

See the Assessments Levied and Uncollected heading under the **General Comments Regarding the Conduct of Business** section of this report.

Did that assessment provide for all losses, expenses and other liabilities, including borrowed money?

No. The 2002 premium assessment did not provide for all 2002 losses, expenses and other liabilities, including the year ending 2001 $104,468.08 outstanding principal loan balance payable to First Tennessee Bank which was carried over from the 2000 business year.

Amount of money borrowed since date of last assessment.

The Company borrowed $140,000.00 from a credit line from First Tennessee Bank to make up for insufficient income and repaid the $140,000.00 principal amount plus $3,953.98 interest on February 14, 2003.

The $140,000 outstanding principal amount borrowed from First Tennessee Bank and $3,953.98 interest was paid in full on February 14, 2003.

Exhibit of Risks

		Amount
1.	In force, December 31, 2001	$44,008,162
2.	New Business Written in 2002	$2,104,000
3.	Business Renewed in 2002	$1,433,400
4.	Total	47,545,562
5.	Deduct those expired and marked off as terminated	$5,232,512
6.	Deduct Amount Reinsured in 2002	$9,104,750
7.	In force, December 31, 2002	$33,208,300

Financial Statement

Income

Gross Membership Fees		$2,664	
Gross Assessments	$426,234		
Deduct : Reinsurance Premiums	(72,808)		
and Return Assessments	(4,339)		
Net Assessments		$349,087	
Borrowed Money		140,000	
Re-Insurance Sliding Scale Commissions & Adjusting Expense		5,478	
Miscellaneous Income		1,750	
Total Income		$498,979	
Ledger Assets, December 31, 2001		18,869	
Total Income and Balance			$517,848

Disbursements

Gross amount paid policyholders for losses	$112,082	
Deduct: Reinsurance loss collections	(11,069)	
Net amount paid policyholders for losses	$101,013	
Expenses of adjustment and settlement of losses	158,028	
Commission or brokerage, including membership fees retained by agents	2,656	
Salaries and compensation of officers, directors, & employees	46,752	
Office Supplies	2,184	
Postage	1,591	
Legal expenses	2,359	
Janitor, Building repairs & maintenance	1,310	
Taxes & Insurance	3,699	
Insurance department licenses and fees	11,387	
Social Security, Medicare, and FUTA	22,059	
Borrowed money repaid (Principal - $104,468; Interest - $2,383)	106,851	
Utilities	5,091	
Group health insurance premiums	25,746	
Miscellaneous expense	4,396	
Total disbursements		$495,122
Balance		$22,726

Assets

Cash in banks	$5,565
Petty Cash	10
Assessments Levied and Uncollected	*6,449
Land and Building	**17,298
Total admitted assets (per Company)	***$29,322

* See the Assessments Levied and Uncollected heading under the **Comments on any apparent violations of the laws of the State of Tennessee** section of this report.

** See the Investment in Home Office Land and Building heading under the **Comments on any apparent violations of the laws of the State of Tennessee** section of this report.

*** See the Total Admitted Assets Per Examination heading under the **Comments on acts of officers and directors; any apparent violations of the Association's By-Laws, or of the laws of the State of Tennessee; general comments regarding the conduct of business:** section of this report.

Liabilities

Line of Credit principal amount borrowed	140,000	
Total Liabilities		140,000
Total Net Worth (Surplus) (per Company)		****$(110,678)

**** See the Negative Net Worth (Surplus) heading under the **Comments on acts of officers and directors; any apparent violations of the Association's By-Laws, or of the laws of the State of Tennessee; general comments regarding the conduct of business:** section of this report.

Assets

Schedule of Bank Deposits:

Name of Bank	Amount on Bank Statement	Amount of O/S Checks	Adjustment Items	Balance
First Tennessee Bank	$6,290.19	$725.15		$5,565.04
Total	$6,290.19	$725.15		$5,565.04

Schedule and description of all other assets, including real estate, mortgage loans, bonds, etc., and interest or rents due or accrued thereon:

Land and Building: $17,298; Building consists of ½ of existing brick and block structure, carried at book value. The Warranty Deed states the Company bought the building from Florence H. Owens on November 30, 1966 for $8,000. The Company does not appear to have depreciated the original cost of the land and building based upon the $17,298 book value stated in the 2002 Annual Statement.

Cash Basis Accounting allows the Company to carry the land and building at market value. However, the Company has not had their land and building appraised and was not aware of the market value of the land and building as of year-end 2002. The $17,298 value stated in the 2002 Annual Statement appears reasonable based upon the historic downtown Dandridge, Tennessee location. Normally the $17,298 asset value for the Company's land and building as shown in the 2002 Annual Statement would have been admitted for purposes of this examination. However, Tenn. Code Ann. § 56-3-405 and Tenn. Code Ann. § 56-3-402(15) only allows this investment up to 15% of admitted assets or $3,431.00. The admitted assets per examination as of December 31, 2002 were determined to be $22,873.00 before the land and building adjustment. See the Investment in Home Office Land and Building heading under the **Comments on any apparent violations of the laws of the State of Tennessee** section of this report.

Assets pledged or hypothecated:

None. The Company pledged premiums receivable to First Tennessee Bank as collateral under the terms of a Line of Credit Agreement. Premiums receivable on a cash basis are not considered to be admitted assets of the Company.

Liabilities

Schedule of Bank Loans:

Name of Bank	Amount Outstanding	Balance
First Tennessee Bank	$140,000	$140,000
Total	$140,000	$140,000

Comments on claims, borrowed money and other liabilities:

The Company established a line of credit of $125,000 from First Tennessee Bank on July 25, 1995. Available line of credit has been modified to $225,000 in 1996; $275,000 in 1997; & $315,000 in 1998. In 2001 the Company borrowed $0.00 but had a line of credit outstanding balance of $104,468. The $104,468 principal amount plus $2,382.88 interest was paid in full on January 31, 2002. In 2002 the Company borrowed a total amount of $140,000 against this line of credit. The $140,000 principal amount plus $3,953.98 interest was paid in full on February 14, 2003. The Company had no liabilities as of February 15, 2003. In 2003 the Company borrowed a total amount of $205,000 against this line of credit.

According to the Company's Annual Statements, Examination Reports and other records the total amount of money borrowed from banks from 1987 through 2003 was $2,960,000.00.

According to the Company's Annual Statements, Examination Reports and other records the total amount of interest and loan fees repaid to banks from 1987 through 2003 was $136,066.56.

According to the Company's Annual Statements, Examination Reports and other records the total amount of principal, interest and loan fees repaid to banks from 1987 through 2003 was $2,895,534.64.

The $140,000 amount borrowed in 2002 evolved from excessive compensation paid to directors, officers, agents / adjusters and employees during the 2002 business year and in previous business years. As of December 31, 2002 the Company could not repay the $140,000.00 outstanding principal amount before 2003 pre-assessments were returned by the policyholders in January, February and March of 2003. The move from post-assessment billing in 2001 to pre-assessment billing in 2002 did not eliminate the Company borrowing money in 2002 or 2003. The Company continued to pay an exorbitant amount of compensation to directors, officers, agents / adjusters and employees for salary, compensation, loss adjustment expenses, policy underwriting expenses and health insurance benefits.

The Company in order to continue to repay principal and interest borrowed ($106,851 or 25% of 2002 Gross Premium Assessments) from the previous year (2001) and the excessive amount of compensation paid to directors, officers, agents / adjusters and employees ($252,583.25 or 59% of 2002 Gross Premium Assessments) during the current year (2002) as well as net policyholder losses ($101,013 or 24% of 2002 Gross Premium Assessments), reinsurance premiums ($67,949 16% of 2002 Gross Premium Assessments) and other general business expenses the Company had to borrow $140,000. The Company since 1993 was in a cycle of borrowing money every year and repaying the principal and interest the following year (or second following year) when the majority (approximately 90%) of assessed premiums were paid by the policyholders in January, February and March.

Claims appear to be paid promptly and to the satisfaction of the Policyholders.

Comments on acts of officers and directors; any apparent violations of the Association's By-Laws, or of the laws of the State of Tennessee; general comments regarding the conduct of business:

Negative Net Worth (Surplus)
The Company's 2002 Annual Statement showed the Company had a negative net worth based upon the fact that it had liabilities totaling $140,000 and assets totaling $29,321.75 on a cash accounting basis. At year end 2002 the Company had a negative net worth of ($110,678.25). The Company has had a negative net worth on a cash basis since December 31, 1993 based upon Annual Statements the Company has filed with the Tennessee Department of Commerce and Insurance.

At year end 2002 the Company had an outstanding loan balance of $140,000.

Examination procedures using Tennessee Code Annotated, Title 56, revealed the Company had an even larger negative net worth as compared to the Company's 2002 Annual Statement. The examiners determined the Company had liabilities totaling $140,000 and assets totaling $9,006.00 on a cash basis. For purposes of this examination the Company had a negative net worth of ($130,994.00) at year-end 2002.

Total Admitted Assets Per Examination
The Examiners deducted the $13,867.05 non-admitted portion of the Company's statement value of its home office land and building as of year-end 2002 in accordance with Tenn. Code Ann. § 56-3-405 and Tenn. Code Ann. § 56-3-402(15) and the total $6,448.75 non-admitted amount for premium assessments levied and uncollected in accordance with Tenn. Code Ann. § 56-3-405 in order to calculate the $9,006 Total Admitted Assets Per Examination.

Income Statement Error
The Company incorrectly listed Reinsurance Collected on Direct Losses on the Schedule of Income (Section II) and the Schedule of Disbursements (Section III) on the 2002 Annual Statement. The Company should only deduct Reinsurance Collected on Direct Losses from Gross Amount Paid Policyholders for Losses on the Disbursements Statement, Section III of the Annual Statement.

The Company should separately disclose Reinsurance Sliding Scale Commission on the Schedule of Income, Section II instead of netting this amount with Reinsurance Premiums.

Income Statement Error
The Company incorrectly listed Reinsurance Premiums on the Schedule of Disbursements (Section III) on the 2002 Annual Statement. The Company should deduct Reinsurance Premiums from Gross Assessments on the Income Statement, Section II of the Annual Statement.

Comments on acts of officers and directors; any apparent violations of the Association's By-Laws, or of the laws of the State of Tennessee; general comments regarding the conduct of business (cont.):

Director / Officer / Agent Compensation # 1

The Company appeared to be engaging in business practices that violate Tenn. Code Ann. § 56-22-130 "Person responsible for accepting or rejecting insurance shall be compensated otherwise than by commissions". Tenn. Code Ann. § 56-22-130 states "No officer or person whose duty it is to determine the character of risk and upon whose decision the application shall finally be accepted or rejected shall receive as any part of such person's compensation a commission upon the premium, but the compensation shall be a fixed salary, or such share of the net profits of the corporation as the directors may determine".

All of the Company's Agents were responsible for accepting or rejecting insurance applications. The Company in 2002 paid its agents $15 per existing policy rewritten and loss adjustment inspection made (one payment per loss only). Officer / Agent E. L. Gantte regularly and Officer / Agent L. C. Batson occasionally received $30 a day or partial day per new policy written, policy rewritten or loss adjustment and $0.35 cents a mile driven for each new policy written, each existing policy re-written or each loss adjustment visit made.

Director / Officer / Agent Compensation # 2

The Company appeared to be engaging in business practices that violate Tenn. Code Ann. § 56-22-112 "No debts created except for the payment of losses". Tenn. Code Ann. § 56-22-112 states that "the officers of the corporation shall not enter into any contract or agreement or make any debt of any kind, except for the payment of losses".

On May 25, 1989 the Company's Board of Directors approved "that a fee of $30.00 dollars per day or any part thereof, plus travel allowance of $0.25 cents per mile, be paid to Director Everett Gantte concerning re-insurance inspections, or for inspections or mileage incurred by Director Gantte if his assistance is requested by another Director or Agent regarding the issuance of coverage or loss inspections, or for any other reason pertaining to Company business".

Throughout 2002 the Company's Officers / Agents were paid $15 per policy rewritten and loss adjustment visit made (one payment per loss only). Officer / Agent E. L. Gantte regularly and Officer / Agent L. C. Batson occasionally received $30 a day or partial day per new policy written, policy rewritten or loss adjustment inspection and $0.35 cents a mile driven for each new policy written, each existing policy re-written or each loss adjustment inspection made.

Also, the Company from September 1 through December 31, 2002 paid all agents Entrance Fees for new insurance, which consisted of $5.00 per $1,000 (all lines except mobile homes) and $10.00 per $1,000 for mobile homes.

Comments on acts of officers and directors; any apparent violations of the Association's By-Laws, or of the laws of the State of Tennessee; general comments regarding the conduct of business (cont.):

Director / Officer / Agent Compensation # 2 (continued)
Finally, the Company provided health insurance coverage for the following Directors / Officers / Agents: Mr. Danny N. Layman, Mr. Everett L. Gantte and Mr. L. C. Batson. Furthermore, the Company provided Health Insurance coverage for the following Agent and Bookkeeper: Mr. Alvin L. Carpenter and Julianne Martin. The Company's total cost of health insurance coverage in 2002 was $25,745.93 for the aforementioned employees.

Claim Repair Work
The Company appeared to be engaging in business practices that violate "Pecuniary Interest" laws set forth in Tenn. Code Ann. § 56-3-103.

Mr. Danny Layman at year-end 2002 was Director, Officer and Agent of the Company. Mr. Layman, also at year-end 2002, was the owner of Layman Construction Company (which was located in Dandridge, Tennessee). The Company would contact Layman Construction Company to repair structures that suffered loss due to fire, wind, hail or lightning that were insured by the Company. The checks issued in 2002 were written to Mr. Danny Layman and not Layman Construction Company. The policyholders did have the right to have any person or entity to repair structures that suffered loss that were insured by the Company.

Investment in Home Office Land and Building
The Company's statement value of its home office land and building as of year-end 2002 was $17,298.00. Tenn. Code Ann. § 56-3-405 only allows this investment up to 10% of admitted assets or $2,287.30. The admitted assets per examination before adjustment for Tenn. Code Ann. § 56-3-405 as of December 31, 2002 were determined to be $22,873.00.

The Company's home office land and building was $15,010.70 more than the total investment maximum permitted by Tenn. Code Ann. § 56-3-405. However, Tenn. Code Ann. § 56-3-402(15) (or the "basket clause") allows the Company to invest an additional 5% of admitted assets in real estate for a total of $3,430.95 admitted assets per exam. Therefore, the Company's $17,298.00 statement value of its home office land and building as of year-end 2002 was overstated by $13,867.05 based upon Tenn. Code Ann. § 56-3-405 and Tenn. Code Ann. § 56-3-402(15). This $13,867.05 will be non-admitted for purposes of this examination.

Assessments Levied and Uncollected
The Company noted $6,448.75 amount for premium assessments levied and uncollected as of December 31, 2002. The Company billed these policyholders on January 2, 2002 and these premiums levied were due March 3, 2002 or 60 days after the billing date. Consequently, these premiums were approximately 260 days past due. This examination as of December 31, 2002 was conducted on a Cash Basis and the Company's $6,448.75 receivable for assessments levied and uncollected will not be admitted for purposes of this examination in accordance with Tenn. Code Ann. § 56-3-405. Tenn. Code Ann. § 56-3-405 does not allow the admittance of assets that are not available for the payment of losses.

Comments on acts of officers and directors; any apparent violations of the Association's By-Laws, or of the laws of the State of Tennessee; general comments regarding the conduct of business (cont.):

Limited Internal Controls Governing the Company's Assets

On May 25, 1989 the Company's Board of Directors approved "that a fee of $30.00 dollars per day or any part thereof, plus travel allowance of $0.25 cents per mile, be paid to Director Everett Gantte concerning re-insurance inspections, or for inspections or mileage incurred by Director Gantte if his assistance is requested by another Director or Agent regarding the issuance of coverage or loss inspections, or for any other reason pertaining to Company business".

Also, on May 25, 1989 the Company's Board of Directors unanimously voted to require "Director Everett Gantte present a report showing dates of inspection, sites inspected, and mileage for each inspection, said report to be presented at the meeting of the Executive Committee."

The underwriting and loss adjustment expense reports that originated from the Company's Directors / Agents provided to the Examiners by the Company did not show dates of inspection, sites inspected, and mileage for each inspection. Also, these underwriting and loss adjustment expense reports provided to the Examiners by the Company did not show whether or not the policy underwritten or policyholder loss inspection was subject to the Company's reinsurance agreements with Farmers Mutual of Tennessee.

The Examiners were unable to determine the accuracy of the underwriting and loss adjustment expense reports submitted by the Company's Directors / Agents without the specific dates of inspection, individual site inspected and mileage traveled to each specific inspection. In 2002 Director Everett Gantte submitted underwriting and loss adjustment expense reports that showed he worked 722 full or partial days (@ $30.00 per day equals $21,660), traveled 218,687 miles (@ $0.35 per mile equals $76,540.80), performed 1,117 re-visits for new policies (@ $15.00 each equals $16,755), 1,151 re-appraisals for existing policies (@ $15.00 each equals $17,265) and 1,151 loss re-adjustments (@ $15.00 each equals $17,265). In 2002 Director Everett Gantte was paid $149,485.05 for underwriting and loss adjustment work.

Furthermore, only one signer was required on the Company's checks regardless of the amount of payment. Director Everett Gantte in 2002 was the sole signer on twenty-eight (28) out of fifty-three (53) checks made payable to himself. The other twenty-five (25) checks, made payable to Everett L. Gantte in 2002 were signed by the Company's former bookkeeper Mrs. Mildred Rodiffer and the Company's current bookkeeper Mrs. Julianne Martin. These twenty-eight (28) checks issued from the Company's First Tennessee checking account that were signed by and issued to Everett L. Gantte in 2002 were for no less than $3,900.00 each and collectively totaled $124,256.85.

Comments on acts of officers and directors; any apparent violations of the Association's By-Laws, or of the laws of the State of Tennessee; general comments regarding the conduct of business (cont.):

Excessive Compensation of Directors, Officers, Agents and Employees

The Company appears to have paid an excessive amount of money to its officers / agents for compensation and loss adjustment expenses. The 2002 Annual Statement noted the Company paid $101,012.72 for policyholder losses (net of reinsurance) in 2002. The 2002 Annual Statement noted the Company paid $158,027.85 for "expense of adjustment and settlement of losses and agents compensation" or $57,015.13 more than the amount the Company paid for policyholder losses (net of reinsurance) in 2002.

Company records obtained during the examination revealed that the Company paid Mr. Everett L. Gantte, Director, Officer and Agent of the Company, $149,485.05 in 2002 for each new policy written, each existing policy re-written and each loss adjustment inspection made on behalf of the Company. The amount paid to Mr. Gantte constituted 95% of the Company's loss adjustment expenses and policy underwriting fees paid to its agents in 2002. Also, the Company paid $48,472.33 more to Mr. Gantte for loss adjustment expenses and policy underwriting fees than it did policyholder losses in 2002.

Based upon the Company's 2002 Annual Statement it appears the Company's cost of directors, officers / agents and employees salary ($46,751.65), agents compensation and expense payments ($158,027.85), health insurance coverage ($25,745.93) and F.I.C.A. withholding, social security, medicare, state contributions and F.U.T.A. ($22,058.55) was a material amount of money to the Company. The total cost of all directors, officers / agents and employees' salary, compensation, loss adjustment expenses, policy underwriting expenses and benefits (noted above) in 2002 was $252,583.25 or $151,570.53 greater than the $101,012.72 amount paid policyholders for losses (net of reinsurance) as listed on the Company's 2002 Annual Statement. Due to the cost of the officers, agents and employees' salaries, agents' compensation and expense payments, health insurance coverage and F.I.C.A. withholding, social security, medicare, state contributions and F.U.T.A., the Company had to borrow $140,000 from First Tennessee Bank in 2002 to pay employee related business expenses and losses. Tenn. Code Ann. § 56-22-112 only allows the Company to borrow money to pay losses.

By-Laws

Article V, Section 1 of the Company's Bylaws states the Company shall have a Board of nine (9) Directors. Article V, Section 2 gives the President the responsibility to appoint vacant Board positions until the next annual meeting. At present, the Company only shows election of three (3) Directors. Tenn. Code Ann. § 56-22-126 states the Board of Directors shall not have less than six (6) members.

Comments on acts of officers and directors; any apparent violations of the Association's By-Laws, or of the laws of the State of Tennessee; general comments regarding the conduct of business (cont.):

Insurance

Type: Assumption of Liability Agreement
Insurer: Farmers Mutual Hail Insurance Company of Iowa
Term: Effective January 1, 2002 and terminates January 1, 2003.
Coverage: Covers 100% of any amount paid or payable by the Company in excess of the policy limits, but otherwise within the terms of its policy, as a result of an action against the Company by its insured or its insured's assignee to recover damage the insured is legally obligated to pay to a third party claimant because of the Company's alleged or actual negligence or bad faith.

The Company had Employee Dishonesty, Commercial Property Coverage, Commercial General Liability Coverage, Commercial Inland Marine (for Accounts Receivable), Workers Compensation and Employers Liability (for Accident and Disease of employees) policies with State Automobile Mutual Insurance Company at a total cost of $3,047.00 for 2002.

The Company provided Health Insurance coverage for Mr. Danny N. Layman, Mr. Alvin L. Carpenter, Mr. Everett L. Gantte and Julianne Martin at a total cost of $23,104.92 for 2002.

The Company provided Medicare Supplement Insurance coverage through New Era Life of the Midwest for Mr. L. C. Batson at a total cost of $1,345.01 for 2002.

Also, the Company provided Cancer Insurance coverage through Continental Life Insurance Company of Brentwood, Tenn. for Mr. Danny N. Layman, Mr. L. C. Batson, Mr. Everett L. Gantte and Julianne Martin at a total cost of $1,296.00 for 2002.

Statement of Accounting
This examination as of December 31, 2002 was conducted on a Cash Basis as compared to Accrual Basis accounting. The Annual Statement format for all Tennessee "County Mutual" Insurance Companies is based upon the statement of assets, liabilities, income and expenses on a cash basis.

Location of Books and Records
All of the Company's books and records were kept in its office building located at 1205 Gay Street in Dandridge, Tennessee, 37725.

Recommendations:

It is recommended that the Company implement the following measures of corrective action for purposes of complying with statutory requirements:

1. The Company should cease from compensating their agents who are responsible for accepting or rejecting insurance applications by any other method except by a fixed salary or share of the net profits as determined by the directors. This practice was in violation of Tenn. Code Ann. § 56-22-130 "Person responsible for accepting or rejecting insurance shall be compensated otherwise than by commissions".

2. The Company should cease from executing any contracts or agreements with any individual or entity or make any debt of any kind, except for the payment of policyholder losses. The Company's employee compensation method of expense payments and health insurance coverage and unnecessary business expenses were in violation of Tenn. Code Ann. § 56-22-112 "No debts created except for the payment of losses".

3. The Company should cease from violating Tenn. Code Ann. § 56-22-112 "No debts created except for the payment of losses". Due to the excessively high cost ($252,583.25 or $151,570.53 greater than the $101,012.72 amount paid policyholders for losses (net of reinsurance) as listed on the Company's 2002 Annual Statement)of the officers, agents and employees' salaries, agents' compensation and expense payments, health insurance coverage and F.I.C.A. withholding, social security, medicare, state contributions and F.U.T.A., the Company had to borrow $140,000 from First Tennessee Bank in 2002 to pay employee related business expenses and losses. Tenn. Code Ann. § 56-22-112 only allows the Company to borrow money to pay losses.

4. The Company in 2002 paid their Vice-President / Agent, Danny Layman, owner of Layman Construction Company to repair structures that suffered loss due to fire, wind, hail or lightning that were insured by the Company. This was in violation of "Pecuniary Interest" laws set forth in Tenn. Code Ann. § 56-3-103. The Company should refrain from these actions.

5. Article V, Section 1 of the Company's Bylaws states the Company shall have a Board of nine (9) Directors. Article V, Section 2 gives the President the responsibility to appoint vacant Board positions until the next annual meeting. At December 31, 2002, the Company only showed election of three (3) Directors. Tenn. Code Ann. § 56-22-126 states the Board of Directors shall not have less than six (6) members. It is recommended that the Company appoint at least three (3) more Directors to become compliant with Tenn. Code Ann. § 56-22-126 and six (6) more Directors to become compliant with the Company's Bylaws.

Recommendations (continued):

6. The Company noted a $6,448.75 amount for premium assessments levied and uncollected on the 2002 Annual Statement as of December 31, 2002. These premiums were approximately 260 days past due. This examination as of December 31, 2002 was conducted on a Cash Basis and the Company's $6,448.75 receivable for assessments levied and uncollected will not be admitted for purposes of this examination. It is recommended that the Company only show assets on their Annual Statement that meet the requirements of Tenn. Code Ann. § 56-1-405 and that meet the standards of Cash Basis accounting.

See the **Subsequent Events** heading under the **Comments on acts of officers and directors; any apparent violations of the Association's By-Laws, or of the laws of the State of Tennessee; general comments regarding the conduct of business** section of the Examination Report as of December 31, 2003 for actions taken by the Company in order to correct statutory compliance deficiencies.

Conclusion

It was determined that, as of December 31, 2002, the Company had admitted assets of $9,006 and liabilities, exclusive of capital, of $140,000. Thus, there existed for the additional protection of the policyholders, the amount of ($130,994) in the form of unassigned funds (surplus). For purposes of this examination the Company had a negative net worth of ($130,994) at year-end 2002.

The $140,000 outstanding principal amount borrowed from First Tennessee Bank and $3,953.98 interest was paid in full on February 14, 2003.

The complete and courteous cooperation of Mrs. Julianne Martin, Bookkeeper and her assistants, Mr. L. C. Batson, President / Agent, Mr. Everett L. Gantte, Secretary / Treasurer / Agent and Mr. Danny Layman, former Vice-President / Agent extended during the course of the examination is hereby acknowledged.

Respectfully submitted,

James T. Pearce, Jr.

James T. Pearce, Jr.
Insurance Examiner III, EIC

Robert S. Creel
Insurance Examiner II

Examination Affidavit:

The undersigned deposes and says that he has duly executed the attached examination report of Farmers Mutual Fire Insurance Company of Jefferson County, Tennessee, Inc. dated August 13, 2004 and made as of December 31, 2002, on behalf of the Tennessee Department of Commerce and Insurance. Deponent further says he is familiar with such instrument and the contents thereof, and that the facts therein set forth are true to the best of his knowledge, information and belief.

James T. Pearce, Jr.

James T. Pearce, Jr.
Insurance Examiner III, EIC
State of Tennessee

County Davidson
State Tennessee

Subscribed and sworn to before me
this 13th day of
August, 2004.

Helen W. Dorsey
(Notary)